

QTIP/CREDIT SHELTER TRUST SUMMARY

A Qualified Terminable Interest Property ("QTIP") election/trust is a popular estate planning tool that allows for a decedent to control the eventual distribution of assets, while at the same time provide for a surviving spouse during that spouse's remaining life. A QTIP trust is funded with property that is includible in the marital deduction, but for which the ultimate distribution of funds (at the death of the surviving spouse) is determined by the first decedent.

Beginning with 2005 deaths, Maine estates with surviving spouses can also elect to create a separate Maine QTIP trust in order to take advantage of the full federal exclusion amount while deferring Maine tax on amounts in excess of the lower Maine exclusion. The value of the QTIP trust is included in the federal taxable estate of the first decedent, but allowed as part of the marital deduction for Maine estate tax purposes.

The Maine QTIP trust/election must qualify as QTIP property under federal law. This summary assumes that the QTIP trust created by the first spouse's estate is federally qualified and that the surviving spouse is a U.S. citizen.

When a QTIP is combined with a credit shelter trust, a significant tax benefit can result, by taking advantage of the full amount of both spouses' higher federal taxable exclusions.

The usual scenario follows a two-step plan. Upon the death of the first spouse, an amount equaling the federal exclusion is transferred to a credit shelter trust or outright to beneficiaries. The Maine QTIP trust is funded with property included in the federal taxable estate having a value not exceeding the difference between the federal exclusion amount (\$1,500,000 for 2005; \$2,000,000 for 2006) and the Maine exclusion amount (\$950,000 for 2005; \$1,000,000 for 2006). The remaining assets are then transferred to the surviving spouse and included in the marital deduction. The credit shelter trust or outright distribution to beneficiaries is federally taxable to the estate, while the QTIP is subject to the marital deduction for Maine purposes, and is not taxable at the first death. The Maine taxable estate is equal to the federal credit shelter trust less the value of the Maine QTIP. Since the amount of the federal taxable estate (the credit shelter trust or outright distribution) is exactly equal to the federal exemption, the estate owes no federal tax. Likewise, the value of the credit shelter trust less the value of the Maine QTIP trust is equal to the Maine exclusion amount, so the estate owes no Maine estate tax.

When the surviving spouse dies, the federal taxable estate is increased by the value of the Maine QTIP for Maine estate tax purposes. It is important to note that the value of a QTIP trust may (and probably will) change from the date of death of the first spouse to the date of death of the surviving spouse.

For example, a husband dies in 2006, leaving behind an estate worth \$5 million. Upon his death, \$2 million is transferred to a credit shelter trust, \$2 million is passed directly to his wife and the remaining \$1 million is transferred to a QTIP. Since the QTIP is considered a direct transfer to the surviving spouse, it falls under the unlimited marital deduction and is not taxable at this time. Therefore, the husband leaves a taxable estate of \$2 million, but since this total equals the federal exclusion, there is no federal tax liability.

Now, suppose the wife dies in 2007. Assume that her total estate consists of the \$2 million passed directly to her by her husband plus the \$1 million left to her by her husband, via the QTIP trust. After applying the federal exclusion for 2007 of \$2 million, her taxable estate is \$1 million. Had the husband included the additional \$2 million in the marital transfer and not a credit shelter trust and transfer to other beneficiary, the wife's taxable estate would have been \$3 million.

For deaths occurring in 2006, Maine's exclusion is \$1 million. Given the example above, the husband's estate would incur an estate tax liability, since the taxable estate exceeds the Maine exclusion by \$1 million. Maine tax law, however, allows for the deferral of taxation on a portion of an estate such as the one in the example above. Maine allows for a separate QTIP to be created for state purposes, not to exceed the difference between the federal and state exclusion. This state QTIP decreases the Maine taxable estate of the first spouse and increases the transfer to the surviving spouse, thereby increasing the Maine taxable estate of the surviving spouse.

Using the example above, the husband's death would, if set up correctly, trigger a separate Maine QTIP to be created for \$1 million. As a result, the federal taxable estate would be \$2 million, while the Maine taxable estate is \$1 million. The estate tax liability is zero at both the federal and state level. The Maine QTIP assets are subsequently included in the wife's estate at her death, so the value of those assets is only tax-deferred.

Maine Revenue Services will follow federal estate tax law in all cases where Maine law does not specifically conflict with federal law. All estates claiming a Maine QTIP election on the estate tax return (Form 706ME) must attach to the return a specific list and description of the Maine QTIP property.